

## DEPARTMENT OF STATE REVENUE

02-20150399.LOF  
02-20150400.LOF  
02-20150401.LOF**Letters of Findings: 02-20150399; 02-20150400; 02-20150401**  
**Indiana Corporate Income Tax**  
**For the Years Ending 6/30/2010, 6/30/2011, and 6/30/2012**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

**HOLDING**

For-profit Higher Education Institutions were required to include tuition payments - which were paid by the Indiana students who attended Institutions' online courses only - in their numerator of the sales factor in reporting their Indiana corporate income tax. Institutions' online revenue was Indiana source income subject to Indiana income tax.

**ISSUES****I. Corporate Income Tax - Sourcing of Sales of Services.**

**Authority:** IC § 6-3-1-20; IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; IC § 6-8.1-5-4; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Miller Brewing Co. v. Indiana Dep't of State Revenue, 903 N.E.2d 64 (Ind. 2009); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Indiana Dep't of State Rev. v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Sherwin-Williams Co. v. Indiana Dep't. of State Revenue, 673 N.E.2d 849 (Ind. Tax Ct. 1996); [45 IAC 3.1-1-29](#); [45 IAC 3.1-1-38](#); [45 IAC 3.1-1-52](#); [45 IAC 3.1-1-55](#); Letter of Findings 02-20130359 (September 11, 2014).

Taxpayers disagree with the audit's assessment that the audit adjusted their numerator of sales factor - sourcing sales of services rendered in Indiana - to apportion their online revenue for Indiana corporate income tax purposes.

**II. Tax Administration - Underpayment Penalty.**

**Authority:** IC § 6-3-4-4.1; IC § 6-8.1-10-2.1.

Taxpayers state that they are entitled to an abatement of the underpayment penalty.

**STATEMENT OF FACTS**

Taxpayers are three (3) related for-profit higher education institutions that "provide career-oriented educational services." Taxpayers' course programs include, but are not limited to, science, healthcare, technology, business, management, finance, accounting and the arts. Taxpayers maintain various "brick and mortar" campuses in Indiana and outside of Indiana. Taxpayers offer courses on their campuses where students attend in person and work with instructors in classrooms on campus. In addition, Taxpayers offer courses online. The online students, regardless of the students' locations, receive Taxpayers' instructions by electronic means using their own computers at times and places of the students' choices.

The Indiana Department of Revenue ("Department") audited all three Taxpayers' records. One Taxpayer was audited for the tax years ending 6/30/2011 and 6/30/2012. The remaining two Taxpayers were audited for the tax years ending 6/30/2010, 6/30/2011, and 6/30/2012. The audit made various adjustments, which resulted in additional tax liabilities for all three Taxpayers and all tax years at issue.

Taxpayers timely protested the Department's adjustment. Taxpayers' representatives primarily object to the audit

adjustment concerning the tuition payments received from online students, who reside in Indiana during those tax years. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

## DISCUSSION

### I. Corporate Income Tax - Sourcing of Sales of Services.

The Department's audit adjusted Taxpayers' sales factor. The audit determined Taxpayers incorrectly excluded revenue they received from online students who resided in Indiana in their numerator of the sales factor—one factor in apportioning Taxpayers' Indiana income tax for the tax years at issue. The audit determined that Taxpayers should have included their "sales of online courses taken by Indiana students." The audit adjustment resulted in additional Indiana income tax.

Taxpayers disagreed with the audit's adjustment concerning numerator of the sales factor. Taxpayers stated as follows:

In calculating Indiana adjusted gross income, [Taxpayers] applied a cost-of-performance methodology in the attribution of online revenue from students residing in Indiana. Under this methodology, [Taxpayers have] sourced the revenue from online educational services based on the location where the greater proportion of the course development and production costs were incurred. [Taxpayers have] sourced all revenue from Indiana residents to Illinois because the majority of the costs were incurred at the corporate headquarters in [] Illinois, or the online center in [] Illinois.

Indiana mandates that every person who is subject to a listed Indiana tax must keep books and records, including all source documents, "so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." IC § 6-8.1-5-4(a). "If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(a). All tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012). "Each assessment and each tax year stands alone." Miller Brewing Co. v. Indiana Dep't of State Revenue, 903 N.E.2d 64, 69 (Ind. 2009). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Also, "all statutes are presumptively constitutional." Indiana Dep't of State Rev. v. Caterpillar, Inc., 15 N.E.3d 579, 587 (Ind. 2014) (citing UACC Midwest, Inc. v. Indiana Dep't of State Rev. 629 N.E.2d 1295, 1299 (Ind. Tax Ct. 1994)). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." Caterpillar, Inc., 15 N.E.3d at 583.

Indiana imposes a tax on the adjusted gross income tax of every corporation that conducts business in Indiana or has income derived from Indiana. IC § 6-3-2-1(b); IC § 6-3-2-2. Under [45 IAC 3.1-1-38](#), a taxpayer is "'doing business' in a state if it operates a business enterprise or activity in such state including, but not limited to:

- (1) Maintenance of an office or other place of business in the state
- (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
- (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
- (4) Rendering services to customers in the state
- (5) Ownership, rental or operation of a business or of property (real or personal) in the state
- (6) Acceptance of orders in the state
- (7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income.

As stated in Regulation 6-3-2-2(b)(010) [[45 IAC 3.1-1-37](#)], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of [IC 6-3-2-2\(b\)-\(n\)](#).

To compute the income subject to Indiana corporate income tax, Indiana adopts a multistep process to calculate a

corporate taxpayer's taxable Indiana adjusted gross income. *Caterpillar, Inc.*, 15 N.E.3d at 581. "In cases where a corporation derives business income from sources both within and without Indiana, the 'adjusted gross income derived from sources within the state of Indiana' is determined by an apportionment formula." *Sherwin-Williams Co. v. Indiana Dep't. of State Revenue*, 673 N.E.2d 849, 851 (Ind. Tax Ct. 1996).

IC § 6-3-2-2 (as in effect for tax years 2009 - 2012), in relevant part, further provides:

(a) With regard to corporations . . . "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) **income from doing business in this state**;
- (3) income from a trade or profession conducted in this state;
- (4) compensation for labor or services rendered within this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property . . .

In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. . . .

(b) Except as provided in subsection (l), if business income of a corporation . . . is derived from sources within the state of Indiana and from sources without the state of Indiana, [] the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana . . . . (**Emphasis added**).

IC § 6-3-1-20 (effective until January 1, 2016) states that " 'business income' means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations." See also [45 IAC 3.1-1-29](#).

To apportion business income for Indiana income tax purposes, Indiana used three factors - property, payroll, and sales - during 2009 and 2010. IC § 6-3-2-2(b)(4). For all taxable years after December 31, 2010, Indiana adopts single sales factor. IC § 6-3-2-2(b)(5).

"The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. Sales include receipts from intangible property and receipts from the sale or exchange of intangible property." IC § 6-3-2-2(e). "The numerator of the sales factor generally includes gross receipts from sales attributable to this state, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. . . ." [45 IAC 3.1-1-52](#).

IC § 6-3-2-2(f) states:

Sales, other than receipts from intangible property covered by subsection (e) and sales of tangible personal property, are in this state if:

- (1) the income-producing activity is performed in this state; or
- (2) the income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

[45 IAC 3.1-1-55](#), in relevant part, further explains:

The term "**income producing activity**" means the act or acts **directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit**. Such activity does not include activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, "income producing activity" includes but is not limited to the following: (1) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service. (2) The sale, rental, leasing, or licensing the use of or other use of tangible personal property. (3) The sale, licensing the use of or other use of intangible personal property.

**Income producing activity is deemed performed at the situs of real, tangible and intangible personal**

**property or the place where personal services are rendered.** The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property. Example: Taxpayer, a corporation whose principal business activity is the manufacture and sale of hot water heaters, obtains notes for the sale of such water heaters in connection with its Indiana business activity. The property has a business situs in this state, therefore, interest income derived from such notes is attributable to this state. (**Emphasis added**).

In this instance, Taxpayers claimed that they should be entitled to "source[] the revenue from online educational services based on the location where the greater proportion of the course development and production costs were incurred." Taxpayers asserted that the costs were incurred in Illinois. Taxpayers argued that they sourced the revenue from online educational services to Illinois because the costs at issue were "at the corporate headquarters in [] Illinois, or the online center in [] Illinois." Taxpayers simply relied on the assertion of their location of their headquarters. Taxpayers did not provide any supporting documentation to support their position of what and where costs were incurred, much less whether they were direct or indirect costs. During the administrative hearing Taxpayers explained that they did not intend to provide any documents to support their protest. Rather, they asserted the costs of performance standard should apply and if the standard applies, the costs at issue were incurred in Illinois. Taxpayers stated that they did not conduct any costs of performance study and therefore did not have one.

Upon review, however, Taxpayers are mistaken on their interpretation of Indiana law. As mentioned earlier, in addition to the statutory requirement of maintaining adequate records, Taxpayers also bear the burden of proof to demonstrate that the Department's proposed assessment was not correct. IC § 6-8.1-5-1(c), IC § 6-8.1-5-4(a). The audit determined that "[t]he revenue received from the Indiana sales transactions constitutes Indiana source income." Specifically, the audit noted, in relevant part, as follow:

There is no value attached to online instructional services if they are not received by a student connected to the internet. [Taxpayers] can perform instructional services in Illinois but if they are not delivered to and received by the student, there is no learning, no receipt of education and no receipt of degree. Online education is an educational format that relies on Internet delivery of educational materials according to the time, place and format that meets the needs and demands of the student rather than the educational institution. The student controls the time and place where the education is delivered and received and where the value of the education is realized. The Indiana [] students enroll in online courses so that they can do their learning in Indiana. Unless [Taxpayers are] able to deliver these educational services to the Indiana students, there is no value for which payment will be made for these services and no revenue earned by [Taxpayers]. . . .

Accordingly, Taxpayers' income at issue does not derive from - however necessary - their activities in their course development and production outside of Indiana. Taxpayers' income tax issue results from Taxpayers' ability to deliver and render their services to the students residing in Indiana by means of online courses and the Indiana students who pay for the services performed in Indiana. The course development and production, standing alone, do not have value unless Taxpayers take steps to ensure that the Indiana students attend the online courses, namely receive the educational services for which they pay. Thus, the income at issue, that Taxpayers classify as revenue from online courses, is attributable to Indiana and subject to Indiana income tax because the income producing activity is performed in Indiana. See also Letter of Findings 02-20130359 (September 11, 2014), 20141126 Ind. Reg. 045140456NRA. In other words, Taxpayers' income producing activity is their sales of their online courses, including giving class instructions to their Indiana students. [45 IAC 3.1-1-55](#). Taxpayers' income producing activity of online courses is deemed rendered in Indiana when the Indiana students attend the online courses.

The Department is charged with enforcing Indiana tax law. Under Indiana Supreme Court law, the Department's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Caterpillar, Inc.*, 15 N.E.3d at 583. Taxpayers objected to the audit determination. Taxpayers however did not offer any documents to support their assertion. Given the totality of circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayers met their burden to demonstrate that the Department's assessments are not correct and that the "cost of performance" rules mandate Taxpayers to source all their online revenue, which were paid by the Indiana students, to Illinois.

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**FINDING**

Taxpayers' protest is respectfully denied.

**II. Tax Administration - Underpayment Penalty.**

It should be noted that the audit waived the ten percent negligence penalty. The Department however determined that Taxpayers failed to make sufficient estimated payments of adjusted gross income tax pursuant to IC § 6-3-4-4.1. The Department thus imposed an underpayment penalty for tax years at issue. Taxpayers requested that the Department exercise its discretion and abate the penalty.

IC § 6-3-4-4.1, in relevant part, states:

(d) Every corporation subject to the adjusted gross income tax liability imposed by this article shall be required to report and pay an estimated tax equal to twenty-five percent (25 [percent]) of such corporation's estimated adjusted gross income tax liability for the taxable year. A taxpayer who uses a taxable year that ends on December 31 shall file the taxpayer's estimated adjusted gross income tax returns and pay the tax to the department on or before April 20, June 20, September 20, and December 20 of the taxable year. If a taxpayer uses a taxable year that does not end on December 31, the due dates for filing estimated adjusted gross income tax returns and paying the tax are on or before the twentieth day of the fourth, sixth, ninth, and twelfth months of the taxpayer's taxable year. The department shall prescribe the manner and forms for such reporting and payment.

(e) The penalty prescribed by [IC 6-8.1-10-2.1\(b\)](#) shall be assessed by the department on corporations failing to make payments as required in subsection (d) or (g). However, no penalty shall be assessed as to any estimated payments of adjusted gross income tax which equal or exceed:

- (1) the annualized income installment calculated under subsection (c); or
- (2) twenty-five percent (25 [percent]) of the final tax liability for the taxpayer's previous taxable year.

In addition, the penalty as to any underpayment of tax on an estimated return shall only be assessed on the difference between the actual amount paid by the corporation on such estimated return and twenty-five percent (25 [percent]) of the corporation's final adjusted gross income tax liability for such taxable year.

IC § 6-8.1-10-2.1(d) states that "[i]f a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return, . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty."

Taxpayers believe that they have "exercised ordinary business care and prudence because [they] calculated [their] Indiana sales factor by sourcing service revenue in accordance with Indiana's statute." Taxpayers claimed that "the income-producing activity is that of the online course development process. This process takes place in Illinois, thus leading to the sourcing of all Indiana online revenue to Illinois. . . ."

Upon review, Taxpayers make a reasonable argument that when they filed their return, they sourced their online revenue based on their interpretation of Indiana law. In addition, the Department did not impose the ten percent negligence penalty after the auditor reviewed Taxpayers' records pursuant to the audit. Rather, the underpayment penalty was imposed due to the deficiency the audit found and the adjustments. In other words, the audit's adjustments increased Taxpayers' taxable income and, as a result, Taxpayers' estimated payments for the tax years became underpaid. Considering all circumstances, the Department is prepared to agree that the underpayment penalty should be abated.

**FINDING**

Taxpayers' protest is sustained.

**SUMMARY**

For the reasons discussed above, the underpayment penalty should be abated. Taxpayers' protest of Issue I, however, is respectfully denied.

